PERAC
COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION
PHILIP Y. BROWN, ESQ., *Chairman* JOSEPH E. CONNARTON, *Executive Director*
Auditor SUZANNE M. BUMP | KATHLEEN M. FALLON | KATE FITZPATRICK | JAMES M. MACHADO | ROBERT B. McCARTHY | JENNIFER F. SULLIVAN

MEMORANDUM

TO: Watertown Retirement Board

FROM: Joseph E. Connarton, Executive Director

RE: Approval of Funding Amount for FY19

DATE: November 3, 2017

This Commission is hereby furnishing you with approval of the amount to be appropriated by your system for FY19. You provided us the schedule the Board recently adopted (copy enclosed) which assumes payments are made on July 1 each fiscal year. The schedule is effective in FY18 (since the amount under the prior schedule was maintained in FY18) and, at this time, is acceptable only through FY19. Our understanding is that another valuation will be performed as of January 1, 2018. We will wait for the results of that valuation before approving an amount to be funded for FY20 (or approving a complete schedule).

The System is approaching fully funded status (100% funded) in the next few years. When a system becomes fully funded, there are still annual normal cost payments (for benefits being accrued in the current year by active members). But attaining fully funded status is no guarantee of maintaining that status. Actuarial and investment losses (reflecting experience worse than anticipated), changes in plan provisions, and/or assumption changes can cause a once fully funded plan to again have unfunded liabilities.

The proposed schedule shows a significant decrease in funding level in 2020 (approximately $10 million) as the last payment of the amortization of the unfunded actuarial liability is made. The FY21 amount reflects another significant reduction as it reflects only normal cost. But as outlined above, an actuarial loss or changes in plan assumptions in the 2018 actuarial valuation (discussed in further detail below) could significantly alter the expectation of reaching full funding in FY21. For example, the current schedule based on the January 1, 2015 actuarial valuation had an expectation of reaching full funding in FY20, one year earlier than the proposed schedule. The FY19 appropriation under that schedule was about $4 million less than that of the schedule just adopted. Actuarial losses in 2015 and 2016 contributed to extending the amortization of the unfunded liability.

As a budgetary matter, we prefer a more gradual approach to reducing appropriation levels as a system nears, and then reaches, full funding. This is the reason we are only approving the proposed schedule through FY19. Past experience of several systems that attained full funding has shown us that reducing the appropriation to the level of only normal cost (or less) could require significant increases in funding if the system does not maintain its full funding status. We are available to discuss this issue and our recommendations further.

The revised schedule reflects a 7.9% investment return assumption (a reduction from the 8.0% assumption used in the 2015 valuation). Although this assumption was reduced, the 7.9% assumption is one of the highest of any Chapter 32 plan. Only 6 systems use a higher assumption (8.0%). As of January 1, 2013, PERAC reduced its “standard” investment return assumption for local system valuations from 8.0% to 7.75%. In our January 1, 2015 valuations, we generally recommended a further reduction. In our January 1, 2016 valuations, we generally recommended a 7.50% assumption. In our January 1, 2017 valuations we generally recommended a maximum 7.50% assumption. There are 56 systems currently with an assumption of 7.50% or less. There are 95 systems that use an assumption of 7.75% or less. We expect several more systems will have adopted an assumption of 7.50% or less after the 2017 valuations are completed.

As part of this valuation, the Board adopted a fully generational mortality assumption based on a recent experience study performed by your actuary. Although we have recommended adopting a fully generational mortality assumption for several years, the assumption we use for other local systems is based on our analysis of State retirees and reflects longer life expectancy than the assumption you have adopted. The valuation also reflects the adoption of other demographic assumptions based on the experience study. We have not performed a recent experience analysis for local systems to compare our findings with the results of your actuary’s study, although we plan to complete a study of retiree mortality for local systems over the next year. The revised assumptions are less conservative than the current standard PERAC assumption set, which we continue to believe is reasonable. We note the employer normal cost has decreased over 50% from the level of the 2015 valuation.

The valuation uses a salary increase assumption of 3.5%. Only about 10 systems use an assumption of 3.5% or less. We expect that over the longer term, this assumption will need to be increased (and/or the investment return assumption further decreased) which will increase plan liabilities.

Aside from the potential impact of plan provision or assumption changes, net losses with respect to any of these assumptions in the 2018 or future valuations would increase plan liabilities, extend the period until reaching full funding, and require larger future appropriations than the amounts shown on the attached schedule. We note the actuarial valuation shows a significant loss due to retiree mortality yet our understanding is that the impact of the revised mortality assumption decreased the plan’s actuarial liability.

We are available to discuss these issues further. If you have any questions, please contact PERAC's Actuary, Jim Lamenzo, at (617) 666-4446, extension 921.

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Appropriation Forecast

Fiscal Year Ending	Payroll*	Employee Contribution	Employer Normal Cost with Interest	Amortization Payments with Interest	Employer Total Cost with Interest	Employer Total Cost % of Payroll	Funded Ratio %**
2018	$35,192,067	$2,956,549	$687,975	$16,235,521	$16,923,496	48.1	80.6
2019	$36,599,750	$3,119,997	$668,557	$17,780,185	$18,448,742	50.4	87.7
2020	$38,063,740	$3,291,790	$646,485	$7,654,471	$8,300,956	21.8	96.0
2021	$39,586,289	$3,472,335	$621,577	$159,462	$781,039	2.0	99.7
2022	$41,169,741	$3,662,057	$593,643	$241,112	$834,755	2.0	99.8
2023	$42,816,530	$3,861,400	$562,479	$250,756	$813,235	1.9	99.9
2024	$44,529,192	$4,070,832	$527,872	$0	$527,872	1.2	100.0
2025	$46,310,359	$4,290,840	$489,597	$0	$489,597	1.1	100.0
2026	$48,162,774	$4,521,935	$447,415	$0	$447,415	0.9	100.0
2027	$50,089,285	$4,764,653	$401,075	$0	$401,075	0.8	100.0
2028	$52,092,856	$5,019,553	$350,312	$0	$350,312	0.7	100.0
2029	$54,176,570	$5,287,222	$294,846	$0	$294,846	0.5	100.0
2030	$56,343,633	$5,568,272	$234,383	$0	$234,383	0.4	100.0
2031	$58,597,378	$5,863,347	$168,610	$0	$168,610	0.3	100.0
2032	$60,941,274	$6,173,119	$97,201	$0	$97,201	0.2	100.0
2033	$63,378,925	$6,498,292	$19,810	$0	$19,810	0.0	100.0
2034	$65,914,081	$6,839,601	($63,929)	$0	($63,929)	-0.1	100.0
2035	$68,550,645	$7,197,818	($154,398)	$0	($154,398)	-0.2	100.0
2036	$71,292,671	$7,485,730	($160,574)	$0	($160,574)	-0.2	100.0
2037	$74,144,377	$7,785,160	($166,997)	$0	($166,997)	-0.2	100.0
2038	$77,110,152	$8,096,566	($173,677)	$0	($173,677)	-0.2	100.0
2039	$80,194,559	$8,420,429	($180,624)	$0	($180,624)	-0.2	100.0
2040	$83,402,341	$8,757,246	($187,849)	$0	($187,849)	-0.2	100.0
2041	$86,738,435	$9,107,536	($195,363)	$0	($195,363)	-0.2	100.0
2042	$90,207,972	$9,471,837	($203,177)	$0	($203,177)	-0.2	100.0
2043	$93,816,291	$9,850,711	($211,305)	$0	($211,305)	-0.2	100.0
2044	$97,568,942	$10,244,739	($219,757)	$0	($219,757)	-0.2	100.0
2045	$101,471,700	$10,654,529	($228,547)	$0	($228,547)	-0.2	100.0
2046	$105,530,568	$11,080,710	($237,689)	$0	($237,689)	-0.2	100.0
2047	$109,751,791	$11,523,938	($247,196)	$0	($247,196)	-0.2	100.0
2048	$114,141,862	$11,984,896	($257,084)	$0	($257,084)	-0.2	100.0
2049	$118,707,537	$12,464,291	($267,368)	$0	($267,368)	-0.2	100.0

* Calendar basis

** Beginning of Fiscal Year